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PERSPECTIVE

Streaming for dollars in the music industry

By Michael R. Morris

The music industry is currently transitioning from an “ownership” model to an “access” model. Instead of purchasing CDs or permanently downloading songs via iTunes, Amazon, etc., an increasing share of music listeners are choosing to stream music over the Internet via services such as Pandora, Spotify and Sirius XM. While these streaming services still pay royalties to artists, songwriters, music publishers and record companies, the rates can be miniscule compared to the revenue artists receive from permanent CD and download purchases. Understandably, this seismic shift in consumer consumption of music is a hot topic in the music industry.

Key factors differentiate royalties generated by the digital streaming of music from revenues attributable to permanent purchases and the traditional “terrestrial” broadcasting of music. This is driven by the business and legal relationship between the streaming companies, performance rights organizations (or “PROs,” which are BMI, ASCAP and SESAC in the United States) and the record labels in the streaming age.

In the “old world,” permanent sales of music represented the bulk of the music business — music was sold either as physical product (CDs) or as permanent downloads. Record labels would get a wholesale price per CD from a distributor or digital seller (like Apple iTunes) and pay a royalty to the artist (a percentage based on a wholesale or retail price, depending upon the label and type of sale).

But when a song is streamed on-demand via Spotify or by a non-interactive company like Pandora, there are no traditional royalty-based sales. Royalties get paid solely from the performances of songs and master recordings. Thus, Spotify will usually pay royalties for the performances of the songs to the PROs via “blanket” licenses of the entire catalogs. The PROs negotiate a “blanket” catalog license fee and then divide it between the songwriters and publishers based on the number of streams. So, hypothetically, if ASCAP received a “blanket” license fee of \$1 million for a particular quarter from Spotify, in which there were 5 billion streams of the ASCAP catalog, the per stream rate would be \$.0002. Spotify also pays a fee to stream the sound recordings (via direct licenses with labels), but unlike non-interactive services such as Pandora, these deals are neither set by statute nor publicly disclosed. Also, major companies like UMG, Sony Music and the Warner Group have taken stakes in Spotify and other streaming services,



The New York Times
The Capitol Records Building, a symbol of the music industry, in Los Angeles, March 22, 2012.

raising the issue of whether the labels are trading equity for lower royalty rates, which are shared with artists.

Non-interactive companies like Pandora and Sirius XM also pay royalties for the performance of songs and the master recordings embodying them. However, the rates paid by Pandora and Sirius XM to broadcast songs are based on consent decrees dating back to the 1940s. When such rates came up for renewal, Pandora, ASCAP and BMI couldn’t agree on new terms. Pandora then sued ASCAP and BMI for a judicial rate court determination. To the dismay of the PROs, the district court decision upheld the current ASCAP-Pandora rate (1.85 percent of income) until Dec. 31, 2015. In response to mounting criticism about royalty rates based on antiquated consent decrees, the Department of Justice announced it will review these consent decrees. Hopefully, the DOJ will address the argument that the changing conditions in the music industry should enable PROs to negotiate performance rates to reflect free market conditions. As Rep. Doug Collins succinctly stated: “Should Congress promote more music creation through less regulation?”

Pandora and Sirius XM also pay royalties from digital streaming of master recordings to labels and artists under the Digital Millennium Copyright Act and the Digital Performance Right in Sound Recordings Act, whose rates are set by statute. Such royalties are collected and distributed by Sound Exchange. However, to the chagrin of labels and

artists, Pandora and Sirius XM don’t pay on pre-1972 sound recordings, which are not protected by federal copyright. As a result, both the major labels and “heritage” acts like Flo & Eddie (Mark Volman and Howard Kaylan, p/k/a “The Turtles”) have sued Pandora and Sirius XM under various state copyright and related intellectual property rights laws. In a decision with far reaching effects, U.S. District Judge Phillipe Gutierrez held that under California law, Flo & Eddie owned exclusive rights to the public performance of their pre-1972 recordings of such classics as “Happy Together” and “She’d Rather Be With Me.” The economic consequences of this ruling cannot be overstated — companies like Pandora and Sirius XM could end up paying hundreds of millions of dollars in additional royalties. Not surprisingly, Sirius XM has appealed. In the meantime, Flo & Eddie have brought similar suits in other states, while a group of labels is pursuing its own action against Pandora in New York.

The legal battles over what rates should be paid for the digital performance of songs and pre-1972 master recordings are hardly surprising, and the Flo & Eddie California case may open a floodgate of litigation. This was predictable, given overall U.S. music revenue during 2013 was flat at \$4.47 billion, down from a \$14.6-billion peak in 1995. While consumer appetite for streaming music has grown exponentially and seems insatiable, digital revenues have not even remotely kept pace.

Certainly Spotify, Pandora and similar services enable more people to experience a wider variety of music, arguably providing more access to and exposure for artists than ever before. But present music streaming models haven’t materially offset lost permanent sales revenues. In this climate, music creators have and will continue to suffer. Consumer habits have changed, and the economics of the music industry in a streaming world must change as well.

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